

# Taxation - The Statute of Limitations in Taxation

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court reasoned that the district would become commercial in a short time, and that such location would enhance the value of the surrounding property as business property.<sup>12</sup> This seems to be the better solution to the matter from a practical standpoint since the business is a necessary business and should not be required to locate in commercial districts where traffic is congested or in outlying districts where they will be difficult to reach.

LOUIS R. GILBERT

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**Taxation — The Statute of Limitations in Taxation** — In 1931 taxpayers exchanged old stock for new in a corporate reorganization. In answer to taxpayers' request for a ruling on the transaction and having a full disclosure of all the facts, the Commissioner advised them that the 1931 transaction was a non-taxable corporate reorganization requiring a carry over of the basis of the old stock to the new stock. However, on sale of the new stock in 1941, 1942, and 1943 the taxpayers used the fair market value of the new stock in 1931 as the basis, contending that the 1931 transaction was not a tax-free reorganization. The Commissioner now concedes that the original transaction was taxable, but asks that the taxpayers should not be allowed, long after the statute of limitations bars deficiency assessment for the original transaction, to change their position. *Held*: Neither the doctrine of consistent dealing nor estoppel will be employed to compel the taxpayer to be consistent in treatment of a transaction if the taxpayer in good faith makes full disclosure of all relevant facts to the Commissioner even though the later inconsistent treatment results in a tax benefit to the taxpayer. *Commissioner of Internal Revenue v. Mellon, Commissioner of Internal Revenue v. Scaife*, 184 F. (2d) 157 (3d cir., 1950).

In this case the Commissioner is seeking to compel the taxpayers to perpetuate an error because he is barred by the statute of limitations from collecting the tax payable were the original transaction now treated correctly. He is in effect trying to circumvent the bar of the statute of limitations by compelling the taxpayer to carry over an incorrect basis, thus including in the tax gains which should have been taxed on the original transaction.

In the following special situations Congress has lifted the bar of the statute of limitations by legislative action:

a) Where there is fraud or no return at all, the statute does not start to run.<sup>1</sup>

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<sup>12</sup> *Frentiss v. Sicard*, 181 Ark. 173, 25 S.W. (2d) 18 (1930).

<sup>1</sup> IRC §276 (a).

b) In cases of gross omission, the normal statute is supplanted by a five year statute of limitations.<sup>2</sup>

c) In cases falling under § 3801 of the Internal Revenue Code, the statute does not apply.<sup>3</sup>

In addition to this legislative relief, the courts have applied certain judicial doctrines to ameliorate the effect of the statute in deficiency actions:

d) If the evidence is not sufficient to establish fraud, but indicates bad faith, the taxpayer is held estopped from changing his position.<sup>4</sup> If applied to the present facts, he would be required to carry over his old basis allowing the Commissioner now to pick up the gain which should have been taxed on the original transaction.

e) If the evidence is not sufficient for an estoppel, but still indicates something misleading, the taxpayer is held to a duty of consistency giving the same results as group (d).<sup>5</sup>

In the development of these judicial doctrines the courts were reluctant to ameliorate the statute by estopping the taxpayer from correcting his error after the statute had run, and apparently were unanimous in requiring proof of bad faith on the part of the taxpayer before applying estoppel.<sup>6</sup> However, since the quantum of proof necessary to estop the taxpayer was less than that required in fraud cases, the Commissioner attempted to apply estoppel where he failed to prove fraud. If the Commissioner could not prove bad faith sufficient for estoppel, a few courts required the taxpayer to be consistent in his treatment of the transaction, such duty being imposed, however, only where the evidence indicated misleading representations on the taxpayer's part.<sup>7</sup> Thus, a taxpayer who was in good faith and made full disclosure to the Commissioner could correct his treatment of transactions at will after the statute barred a deficiency for the original transaction. He could increase the basis of his property by claiming innocent error in the original tax treatment of the transaction, and escape the tax on the gain giving him the increased basis.

Legislative attempts to correct this defect in the tax structure resulted in § 3801 of the Internal Revenue Code<sup>8</sup> allowing taxation of

<sup>2</sup> IRC §275 (c).

<sup>3</sup> IRC §3801.

<sup>4</sup> See Maguire and Zimet, "Hobson's Choice and Similar Practices in Federal Taxation," 43 Harv. L. Rev. 1281 (1935); Atlas, "The Doctrine of Estoppel in Tax Cases," 3 Tax L. Rev. 71 (1947).

<sup>5</sup> *Ross v. Commissioner*, 169 F. (2d) 483 (1st cir., 1948); *Comar Oil v. Helvering*, 107 F.(2d) 709 (8th cir., 1939).

<sup>6</sup> All the U.S. Courts of Appeal except the 5th and 10th circuits apparently agree.

<sup>7</sup> The strong sense of misrepresentation is indicated in *Bothwell v. Commissioner*, 77 F.(2d) 35 (10th cir., 1935).

<sup>8</sup> Section 3801 of the International Revenue Code which is substantially the same as section 820 of the Revenue Act of 1938, provides in material part as follows:

gains barred by the statute of limitations where, among other situations, the taxpayer changed his basis claiming an error in the treatment of the original transaction. The statute provides that if there is a determination by a court of the basis of the taxpayer's property, and in respect of any transaction on which the basis depends, there was an erroneous omission from gross income, the Commissioner may, notwithstanding that the statute bars correction, assess a deficiency for the original transaction. Although limited in coverage to taxable years following 1931<sup>9</sup> and therefor not applicable to the present case, it is doubtful whether it actually does correct the defect illustrated by the instant case. Judicial construction has limited its applicability by construing strictly the requirement that there be a determination of basis by a court.

In *American Foundation Co. v. Commissioner*,<sup>10</sup> a taxpayer reported a corporate reorganization as non-taxable. This was upheld by the District Court. When the statute had run he changed his position, claimed it was a taxable transaction originally, and increased his basis on the later sale. The Tax Court held that the determination by the District Court that the transaction was non-taxable was not a determination of basis and consequently the requirement of § 3801 for a determination of basis was not met. Significantly the Commissioner does not acquiesce in this decision. However, it was favorably cited by Judge Hand in *Central Hanover Bank and Trust Co. v. United States*,<sup>11</sup> wherein he held that a determination of a deficiency against a taxpayer for sale of stock based on Commissioner's contention that the "first-in, first-out" rule should be applied, did not determine the basis of the re-

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Sec. 3801 Mitigation of Effect of Limitation and other Provisions in Income Tax Cases.

(a) Definitions.—For the purpose of this section. . .

(1) Determination.—The term "determination" under the income tax laws means. . .

(B) A decision by the Board of Tax Appeals or a judgment, decree, or other order by any court of competent jurisdiction, which has become final; . . .

(b) Circumstances of Adjustment.—When a determination under the income tax laws. . .

(5) Determines the basis of property. . .for gain or loss on a sale or exchange. . .and in respect of any transaction on which such basis depends there was an erroneous inclusion in or omission from the gross income. . .

The statute then goes on to provide that correction of the error is to be made under this section if the statute of limitations precludes other corrections.

<sup>9</sup> IRC §3801. . .

(f) No Adjustment for Years Prior to 1932. No adjustment shall be made under this section in respect of any taxable year beginning prior to January 1, 1932.

<sup>10</sup> 2 Tax Ct. 502 (1943).

<sup>11</sup> 163 F.(2d) 60 (3rd cir., 1947).

mainder of the stock sold in the next year; hence, the requirement of § 3801 was not met. In both cases although the tax treatment of the transaction on which basis depended was determined, this was held not to be a sufficient determination of basis to satisfy the statute.

In the present case, the basis of the stock, in event of a favorable decision to the taxpayer, was stipulated, and the court in answer to the Commissioner's contention that the basis as stipulated was in error said, "That issue (of basis) was not raised in the Tax Court," indicating that, although the event determining basis was found, i.e. the reorganization was taxable, basis itself was not determined. Since basis itself was not determined, the decision would not seem to qualify under § 3801, even if a taxable year covered by § 3801 were involved. This is clearly not the result intended by the authors and sponsors of the bill,<sup>12</sup> and one that most courts, it is believed, will not reach.

IRVING W. ZIRBEL

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**Procedure — United States Impleaded Under the Federal Tort Claims Act** — Four passengers were injured in a collision between a taxicab and a United States mail truck. Claiming diversity of citizenship, the passengers sued the Yellow Cab Company in the District Court for the Eastern District of Pennsylvania. Defendant cab company filed a third-party complaint to enforce contribution from the United States. The district court held that the United States could be made a third-party defendant for purposes of contribution under the Federal Tort Claims Act, and the Court of Appeals for the Third Circuit affirmed the judgment.<sup>1</sup> In a similar suit against the Capital Transit Company in the United States District Court for the District of Columbia, for injuries suffered in a collision between a streetcar and a jeep operated by a United States soldier, the opposite conclusion was reached, and affirmed by the Court of Appeals for the District of Columbia Circuit.<sup>2</sup> The Supreme Court granted certiorari in both cases. *Held*: The United States can be sued for contribution under the Federal Tort Claims Act, and can be a third-party defendant for that purpose. *United States v. Yellow Cab Co.*; *Capital Transit Co. v. United States*, 340 U. S. . . ., 17 S. Ct. 399 (1951).

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<sup>12</sup> See McGuire, Surrey, and Traynor, "Section 820 of the Revenue Act of 1938," 48 Yale L. J. 509, 719 (1939). This is a good discussion by the authors of the bill both as to coverage and mechanics of operation.

<sup>1</sup> *Howey v. Yellow Cab Co.*; *Gutmann v. Yellow Cab Co.*, 181 F.(2d) 967 (3rd Cir., 1950).

<sup>2</sup> *Capital Transit Co. v. United States*, 183 F.(2d) 825 (D.C. Cir., 1950).